Program Description and Estimated Impact on Washington Students Federal Hope Scholarship and Lifetime Learning Tax Credits

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BACKGROUND

In 1997, the federal government enacted the Taxpayer Relief Act. This law, which became effective January 1998, provides an array of federal income tax benefits to help families meet the cost of postsecondary education.

The Taxpayer Relief Act marks a systemic change in the way the federal government assists students in financing higher education, in two ways. First, it is directed toward middle-income taxpayers, as opposed to the government's historical focus on providing student financial aid to low-income students. And, second, these programs utilize tax credits, or foregone revenue – rather than direct funding through the appropriations process. It is estimated that, once all the provisions of the Taxpayer Relief Act are fully implemented, the cost to the federal government will approximate the amount now provided through all other existing federal student financial aid programs combined.

Following is a summary of two federal programs established as a part of the Tax Reform Act – the Hope Scholarship and the Lifetime Learning tax credit programs. (See Appendix A for a side-by-side comparison.)

Program Descriptions:

The ***Hope Scholarship Tax Credit Program*** is available to first- and second-year college students. It provides for a tax credit equal to all of the first $1000 of tuition and fees, and half of the next $1000 (less untaxed scholarships, grants, and tuition benefits). The credit may be claimed by parents of dependent students or by students who are not declared as dependents on their parents' income tax return. It may be claimed for each dependent who qualifies, up to the full amount of taxes owed. The maximum per-student credit of $1500 will increase for inflation after 2001.

The Hope Scholarship credit applies only to the first two years of postsecondary education and can be claimed for only two tax years. Students must be enrolled at least half-time in a program leading to a postsecondary degree or certificate. They must attend an institution that has been approved by the U.S. Department of Education for participation in the federal student financial aid programs. And, they cannot have been convicted of a drug felony in the year in which the credit applies. Education expenses paid on or after January 1, 1998, are eligible for the Hope credit.

The full value of the Hope tax credit is available to married taxpayers filing jointly with an adjusted gross income (AGI) of $80,000 or less, and to single taxpayers with an AGI of $40,000 or less. The credit is phased out for married taxpayers with incomes between $80,000 and $100,000; and for single taxpayers with incomes between $40,000 and $50,000. As illustrated in Table 1, the program does not benefit low-income families who owe little or no taxes or families above the eligibility threshold.

Table 1

Overview of Income Eligibility for the Hope Tax Credit

	Dependent Students in a Family of Four	*Single Independent Students*	*Dependent and Independent Students*	
			Filing Jointly	*Filing Singly*
Income too low for any benefits	Less than $17,500	Less than $6,800		
Income too low for full benefits	$17,500-$27,500	$6,800-$16,800		
Income too high for full benefits			$80,000-$100,000	$40,000 - $50,000
Income too high for any benefits			above $100,000	above $50,000

Source: IRS Form 1070 (1997) and IRS Publication 970 (1998)/Federal Tuition Tax Credits and State Higher Education Policy," The National Center for Public Policy and Higher Education, December 1998

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The ***Lifetime Learning Tax Credit*** is a per taxpayer credit, rather than a per student credit. The credit may be based on the combined educational costs of all dependents claimed by a taxpayer, but the total credit cannot exceed the current maximum of $1000.

Unlike the Hope Scholarship credit, it may be claimed for an unlimited number of years for each student and it applies to undergraduate or graduate degree programs, as well as for classes to improve or upgrade job skills. There is no minimum credit load. Like the Hope credit, however, the student must attend an institution that has been approved by the U.S. Department of Education as eligible to participate in the federal financial aid programs. Educational expenses paid on or after July 1, 1998, are eligible for a Lifetime Learning tax credit.

The amount of the Lifetime Learning tax credit is based on 20% of the first $5000 in tuition expenses minus tax-free grants, scholarships, or other tuition assistance. After the year 2002, the allowable credit will be based on the first $10,000 of tuition.

Like the Hope Scholarship, the Lifetime Learning tax credit may be claimed by eligible students who file their own taxes independently, or by families who declare an eligible student as their dependent. As can be seen in Table 2, this program is also targeted to the middle income.

Table 2

Overview of Income Eligibility for the Lifetime Learning Tax Credit (1998-2002)

	Dependent Students in a Family of Four	*Single Independent Students*	*Dependent and Independent Students*	
			Filing Jointly	*Filing Singly*
Income too low for any benefits	Less than $17,500	Less than $6,800		
Income too low for full benefits	$17,500-$24,100	$6,800-$13,450		
Income too high for full benefits			$80,000-$100,000	$40,000 - $50,000
Income too high for any benefits			above $100,000	above $50,000

Source: IRS Form 1070 (1997) and IRS Publication 970 (1998)/Federal Tuition Tax Credits and State Higher Education Policy," The National Center for Public Policy and Higher Education, December 1998

Estimated Impact on Washington Students

Since taxpayers can claim the credit for the first time on their 1998 returns, and since final regulations have not yet been published, it is difficult to forecast with certainty the extent to which Washington students will be affected. Clearly, middle-income taxpayers will be the primary beneficiaries. Low-income families, with little or no tax liability will not be eligible; and those with incomes above the threshold levels will not qualify.

Also of question is how the receipt of grants and scholarships will affect eligibility. Earlier information had indicated that grants would reduce eligibility. However the proposed regulations recently published by the U.S. Department of the Treasury indicate that *untaxed* scholarships, grants, and other tuition assistance will directly reduce the amount of the tax credit. It appears that, by paying taxes on grant assistance, a student could preserve eligibility for the tax credit (assuming there was tax liability).

The Higher Education Coordinating Board has estimated the impact of these new federal tax credit programs on two different subsets of Washington's higher education enrollment: 1996-97 State Need Grant recipients; and Washington residents who received any type or amount of financial aid during the 1996-97 academic year.[1] These reviews posed two different questions: 1) To what extent might the receipt of State Need Grant funds reduce or eliminate a student's eligibility for a federal tax credit; and 2) How will students at various income levels be affected by the tax credits?

[1] A study on the entire enrolled population was not possible, since family income and tax information are available only for financial aid applicants.

State Need Grant Recipients. As a part of its review of State Need Grant (SNG) policies last summer, the Board estimated the potential overlap between the new tax credit programs and students who would be eligible for State Need Grants at three different income levels. The review was specific to SNG recipients who attended full-time for the full academic year. In keeping with information available at that time, it assumed that grant aid would directly reduce the tax credit.

State Need Grants were awarded to students with an income of 40 percent or less of the state's median family income. Eighty-seven percent of the students in the study subgroup at that income level had a tax liability that was less than the amount of the Federal Pell Grant. Since they would not have qualified for a tax credit after their Federal Pell Grant was taken into account, the State Need Grant would have had no affect on the tax credit. An estimated 12 percent would have lost some or all of their tax credit if *both* Pell and State Need Grant offset eligibility. However, since the low-income students who receive SNG's have minimal tax liability, the average amount of the tax credit lost due to receipt of these grant funds was small ($259).

Had SNG's been awarded to students with family incomes up to 65 percent of the state median family income, the overlap between the federal tax credit and the SNG programs would have been greater. The combination of a Pell Grant and a State Need Grant would have reduced or eliminated eligibility for a tax credit for 21 percent of the students in the study group. Overlap between the SNG and the tax credit programs increases as incomes rise. Although the percent of students with overlapping benefits is greater at the higher income level, the average amount of the tax credit lost is still relatively small ($326).

Estimated Impact of Federal Tax Credits on Washington Financial Aid Recipients. Many Washington students will benefit from the federal Hope Scholarship and Lifetime Learning tax credit programs. An analysis specific to Washington residents who received financial aid during the 1996-97 academic year confirms national reports indicating that middle income families will benefit most directly, with little or no benefit to those in the lowest or highest income categories.

HECB staff will continue to monitor the impact of the Hope Scholarship and Lifetime Learning tax credit programs on Washington students.

APPENDIX A

Major Provisions
Federal Hope Scholarship and Lifetime Learning Tax Credit Programs

	Hope Scholarship	**Lifetime Learning**
Student Eligibility	• First two years of college • Two tax-years limit • Enrolled in program leading to postsecondary degree or certificate • Enrolled at least half time • Not convicted during tax year of a felony for possessing or distributing a controlled substance	• Undergraduate or graduate degree, or classes to improve or upgrade job skills • Lifetime eligibility
Income Limits *Note: Incomes will be adjusted for inflation after 2001*	Married, Joint Filer Full Value: Up to $80,000 AGI Partial Value: $80,000 - $100,000 AGI Not Eligible: AGI above $100,000	Single Taxpayer Up to $40,000 AGI $40,000 - $50,000 AGI AGI above $50,000
Maximum Tax Credit *Note: Taxpayer may claim both credits in a given year, but not for the same student.*	$1500 • 100% of first $1000 tuition plus 50% of next $1000 • May be claimed for each dependent who qualifies (up to the amount of taxes owed) • Increased after 2001, based on inflation	$1000 • 20% of up to $5000 tuition • One credit per family • Increased after 2002 to 20% of up to $10,000 tuition.
Qualifying Expenses	Tuition and required fees	
Effect of Grants and Scholarships	Grants, scholarships, fellowships, or other tuition benefits reduce the value of the tax credit unless: • They are reported as income on the federal income tax return; or • The grant must be applied, by its terms, to expenses other than tuition.	